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The United States and Mexican Finance

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THE question of Mexican finance, and especially that phase of it which is involved in the claims of foreign creditors of Mexico, is one of the post-war financial problems which, sooner or later, must receive the serious attention of the United States. In the abstract the general question of Mexican finance is not only one of suitable investment for American funds, but includes the broader problem of so aiding and safeguarding the stability of the government of a neighboring country as to prevent a recurrence of internal disorder and consequent international friction. Involved in the general problem are very complicated phases having to do with the claims of creditors of Mexico—claims of holders of Mexican securities and claims of individuals and corporations for losses or damages incident to the revolutionary period through which Mexico has passed. To arrive at any permanent and satisfactory solution of the problem each factor must be considered with reference to its relation to the whole, and with this in view I propose to take up, in proper order, the immediate conditions and the future needs.

CLASSES OF CLAIMS AGAINST MEXICO

Broadly speaking, claims against Mexico may be divided into three classes, namely: (1) the claims of holders of direct obligations of the Mexican government; (2) claims of individuals or corporations for damages sustained during or as a result of the revolution; and (3) claims of security holders of the National Railways of Mexico. Strictly speaking, the third class should be included in the second, but it will be treated separately for reasons which will be explained later on.

It is not the purpose of this article to deal with individual claims or items, or to attempt any study of questions of priorities of claims or of guarantees involved, but rather to deal with the question as a whole. Without entering into any analysis of the various items constituting the Mexican national or government

debt, this item will be treated as a lump sum. The national debt proper, including various external loans either secured or unsecured, an interior loan, and various minor items such as scrip issued to pay government employes, and a redemption fund to take up bonds given in exchange for the so-called Vera Cruz money, amounts to a total of some \$300,000,000, United States currency. This figure does not include some state, federal district and municipal loans for which the national government is guarantor, and these items, with unpaid and accrued interests, may bring the total to a round figure of \$350,000,000 (for convenience all figures and calculations will be reduced to their equivalent in United States currency). A considerable portion of this total is in loans at $4\frac{1}{2}$ per cent, but for round figures may be taken at 5 per cent, calling for annual interest payments of about \$17,500,000.

DAMAGES ATTRIBUTABLE TO THE REVOLUTION

The next item to be considered is the debts of the Mexican government due to damages done to property during the revolutionary period. There is a popular impression that this item will involve dealing with colossal figures, but this impression is not, I believe, justified by the facts in the case. The principal losses may be grouped under the following heads: destruction of equipment and buildings belonging to the various railways, government-controlled lines and privately-controlled lines; damages to tramway, electric light and other public utility properties; destruction of or damage to factories, sugar mills and other industrial plants; destruction of buildings and equipment on farms, plantations and ranches; loss of live stock; and, finally, financially considered, loss of life. The National Railways system estimates that it will require 50,000,000 pesos, or \$25,000,000, to get back into full operating condition, but, due to high prices of materials now prevailing, this estimate should probably be increased to about \$40,000,000. The National Railway lines constitute about two-thirds of the railway mileage in Mexico, so that, for purposes of estimating the government's liability due to losses of railway property, we may assume, roughly, a total figure of \$60,000,000. As the National Railways will be considered under a separate head, only one-third of this

amount need be, for the moment, considered, although technically, of course, the government must pay the National Railways. Urban public utility properties suffered small damage through destruction, and while hydro-electric properties lost considerable copper cable, their generating plants, as a whole, suffered little. The great mining properties at Pachuca, El Oro, Cananea, Guanajuato and other points suffered only nominal physical damage. Many small mining plants were obliged to close down, and in some, perhaps many cases, their buildings were wrecked or damaged as a result of local disorders. The losses on this class of properties were relatively small, as the damage, while apparently great, was really superficial. Properties in the great oil fields have suffered no damage. Factories have been damaged here and there, but, generally speaking, they are located in large centers which were under constant control, and their losses have been insignificant. Sugar mills in the state of Morelos were wrecked by Zapatistas, and while the complete wreckage of the buildings and machinery on the *haciendas* in this state involves a serious delay in getting back to a production basis, the fact remains that the intrinsic values of the properties—lands, canals, ditches, roads, and so forth—have only been slightly affected. On the average farm or ranch property in other sections buildings remain intact, and the losses are confined to portable equipment, live stock killed or driven off, and so forth. In other words, the potential earning power of rural properties, the basis of real wealth in Mexico, has not been seriously affected. It is true, that, due to disordered conditions, many large agricultural properties have earned nothing, and that, in consequence, their owners have no working capital with which to resume business, but, considering the matter as one of government liability for physical losses, the damage has been relatively small. It is, of course, very difficult, without exhaustive examination, to determine or estimate what the sum total of physical losses to properties will amount to. At a rough guess I should say that the legitimate claims of foreign individuals and corporations will not exceed \$60,000,000, including \$20,000,000 for railway losses, as noted above. If a sum of \$10,000,000 be added for payments which may be made for loss of life, and a further sum of \$30,000,000 be added for awards to Mexicans for damages to rural properties,

then the whole amount for which the government would be held liable would amount to a total of \$100,000,000. This would call for an annual interest charge, at 5 per cent, of \$5,000,000.

In considering the question of losses we can include only such losses as would be allowed by an impartial commission charged with the settlement of the matter. Doubtless the total of claims filed, or to be filed, will greatly exceed the estimate given above, partly because of the general tendency, in dealing with a government, to inflate claims, and partly because the actual losses due to destruction of property, through loss of earning power or through depreciation of neglected property, often exceed the purely physical loss. For instance, the total foreign investment in Mexico amounts to about \$2,000,000,000, and the greater portion of this investment, due to the disturbed conditions or to the fall in the value of the peso during the paper-money period, produced little or no revenue from 1914 to 1916 inclusive, representing, in three years, a total loss, at 5 per cent, of \$300,000,000. While this loss is a real and actual loss, it would not be possible, even with a wild stretch of imagination, to ask the government for compensation for it. The government cannot be held responsible for lack of business, nor could it be held to account for poor earnings because of depreciation in the currency. In so far as revenue was lost because of disturbed conditions or because of currency values, the situation may be compared to the indirect losses due to a fire in a large manufacturing plant—namely, that while these losses may be actually greater than the direct fire losses, no claim for them can be properly made against the fire insurance company.

LIABILITIES OF THE NATIONAL RAILWAYS COMPANY

The affairs of the National Railways Company are so interwoven with those of the government that the liabilities of the railways company may almost be considered as government liabilities. The government's position in the matter is far from satisfactory. Its interest is fivefold: first, through subsidies granted to aid in the original construction of the roads; second, as guarantor of interest and principal on a large part of the bonds issued by the railways company; third, as holder of two-thirds of the common stock and of a considerable portion of the pre-

ferred stock of the company; fourth, as debtor through liability (as a government) for destruction of railway property; and fifth—and perhaps most important of all—through intangible but general interest in the shaping of the policy of a company whose affairs are of vital importance in the development of the resources of the country.

The lines were built by private capital but with the aid of the government, which, at a later date, in order to control future policy, secured, in connection with the consolidation of various companies, a control of the common stock, and was thereby placed in nominal control of the system. The government now finds itself in the position of having aided substantially, by subsidies, in the construction of the railways, of having expended a large sum in acquiring control of the common shares of the system, and of being tied up with large guarantees, covering interest charges and so forth, while its control is technically subject to the claims of various sets of mortgages, interest on which is badly in arrears. In other words, the government, in spite of large expenditures and guarantees, had only a weak equity in the property, and the upheaval in Mexico, through stopping earnings, has placed that equity in jeopardy. The government feels that for reasons of public policy it cannot relinquish control of the system, but it realizes that the claims of the various sets of bondholders must be considered.

The matter is greatly complicated by the fact that the National Railways Company, at its best, has never made a satisfactory showing. The company has, roughly, \$250,000,000 in common and preferred shares, and \$250,000,000 in bonds, notes and accrued interest, or a total of half a billion dollars in capital liability. Gross earnings from 1909 to 1913—before the revolution—were more or less stationary, the maximum reached in any one year being 64,000,000 pesos, or \$32,000,000—a relation of 6.4 per cent as between gross receipts and capital account. Assuming that operating expenses would be two-thirds of gross receipts, there would remain a net of 2.3 on the total capital liabilities, manifestly an absurdly low figure. The highest net earnings of the system in any one year were 21,300,000 pesos, at a rate of about 2 per cent of the present capital liabilities. It is quite clear that there will have to be a reorganization of the finances of the

system on a basis of cutting down the total capital liabilities, and particularly with the object, in order to avoid future disaster, of reducing the fixed charges. Such a reorganization would naturally make provision for sufficient new money to provide additional equipment and thereby increase the earning power of the property.

A THOROUGH REORGANIZATION IMPORTANT

Holders of securities of the National Railways must recognize the fact that while the capitalization of the company is moderate for a system comprising some 9,000 miles of track, the capital account is far too high when considered in the light of earning power. The only hope of a great increase in earning power is through a full development of the agricultural resources of the country, and such a development will only be accomplished with colonization and with the creation of a large class of independent small farmers. With present conditions of great estates—6,000 people own a total of 300,000,000 acres of land, or an average of 50,000 acres each—anything like a full cultivation of the soil is impossible, and the country, which has potential productive capacity to support 75,000,000 people, actually imports corn and wheat. For a proper program of development of national resources it seems important that the government should have a dominating voice in the railway question. Aside from this aspect, it seems probable that because of the condition of their finances most of the railways in Mexico—including many lines in which the government has no direct interest—will, sooner or later, come under the control of the government.

Financial houses, in the reorganization of railway properties, frequently make the mistake of trying to satisfy all classes of creditors by the issue of generous quantities of new securities having no intrinsic value and representing only some indefinite hope of value to be created in the remote future. There seems to be a sort of financial fallacy that if a man owns a hundred dollar bond representing fifty dollars in real value, he should receive, in a reorganization, sixty dollars in new bonds, twenty dollars in preferred stocks and thirty dollars in worthless common stock. Under this sort of a scheme the property in question emerges from the reorganization with a little more capital than before,

and while fixed charges are somewhat reduced, and a better appearance created by liberal use of varnish, the property faces a constant struggle due to its waterlogged condition. It is to be hoped that whatever is done with the National Railways will have in view the creation of a sound financial structure.

This is especially important because of the necessity for a great enlargement of the system in the future. There are great tracts of fertile land which have no railway communication, and any general program which provides for a full development of natural resources will call for an extensive scheme of railway construction. For the present, we may assume that with a financial reorganization and provision of considerable new equipment, the National Railways will be able to earn operating expenses and the major part of their bond interest. It seems improbable that, if properly maintained, the roads can earn all charges even on a more modest capitalization, and it will be well to assume that the government will be called on to pay at least \$2,000,000 and perhaps as much as \$4,000,000 per year to meet deficits. By charging a part of maintenance cost into capital account and by other manipulation of figures a fictitious showing could be made to conceal deficits, but this would only be accumulating trouble for the future.

Mexico needs money for a new government bank, and while the basis on which such money is to be supplied is not yet determined, it may be assumed that it will be self-sustaining, and need not, therefore, be considered so far as the question of government financial needs is concerned. It may also be assumed that the reorganization of the National Railways Company will provide money required for the rehabilitation of the system, and that the railway question need not enter into government finances except as to the question of an annual deficit as outlined above.

THE SITUATION SUMMARIZED

Summarizing the situation, then, we have the following items to be considered:

First: Existing government indebtedness amounting to roughly \$350,000,000, calling for the payment of interest charges of about \$17,500,000 annually.

Second: Payment of claims for destruction of properties, damages to railways (excepting the National Railways), etc., amount-

ting to \$100,000,000, calling for annual interest charges of \$5,000,000. To avoid raising this amount of money it seems probable that, under a proper organization of government finances, creditors in this class would take government bonds for a large portion of their claims.

Third: The National Railways need \$40,000,000 for rehabilitation of their lines and for new equipment. This money will be provided, presumably, in a financial reorganization of the company, and it is assumed that increased earnings will take care of all fixed charges of the system except for a deficit of some \$3,000,000 per year.

Fourth: Money is required, to an amount which may be placed at \$50,000,000, for a new bank of issue, but if this money is obtained it may be assumed that it will be self-sustaining—in other words, that no question of interest charges, so far as government finances are concerned, need be considered.

Fifth: The government requires a considerable sum for general purposes and for the organization of an efficient rural police force to enforce order and to run down bandits, whose operations, in some sections, prevent resumption of agricultural pursuits. It is calculated that \$50,000,000 will be required under the head of general needs, and this would call for an annual interest payment of \$2,500,000.

Taking items one, two, three and five, there would be a total annual interest charge of about \$28,000,000. More than half of this is for interest on old debt, at a fixed rate and presumably creditors under item two would be satisfied with 5 per cent bonds if they were assured as to prompt payment of interest. Money required under item five would probably have to be raised on a basis which would cost the government 6 per cent or more, and possibly total interest charges may amount to \$30,000,000.

A POLICY OF MODERATION THE BEST

There has been more or less of idle talk of a loan of \$300,000,000 or \$400,000,000 to Mexico to enable her to pay off all her debts. Such a plan would provide for more money than is needed, assuming that creditors take a sane view of the matter. The provision of such a sum would inevitably result in extravagance, no matter what restrictions were imposed as to the disposal of the money,

and Mexico is, under a more modest program, far more likely to learn thrift and to realize the necessity of efficient administration than if she were in a position to command large sums of money. The development of two or three years of reconstructive program, accompanied by enforced thrift, will, later on, place the country in a position to obtain all the money she requires for further improvements.

Mexico has already learned much in thrift, and in place of a deficit, two years ago, of over \$5,000,000 a month, she has, above her current military and civil administration expenses, a small surplus. It is expected that for the current year there will be a surplus of 20,000,000 pesos, or roughly \$10,000,000. This, on a basis of the interest charges estimated above, would leave an annual deficit of \$20,000,000. The total government income this year will be in the neighborhood of \$90,000,000. An increase, therefore, of 25 per cent in income would enable the government to meet all its interest obligations. The amount of the national debt, in proportion to the wealth of the country, is very small, and, once normal conditions are restored, the load will not be a heavy one. Moreover, Mexico has gained, indirectly, through conditions brought about by the world war. To pay interest and meet payments on the principal of huge war debts other countries will, automatically, maintain high prices, so that Mexico, which has had no war expense, will profit by the sale of her products at higher prices than would otherwise have prevailed.

DIFFICULTIES OF MEETING THE DEFICIT

The problem of meeting the deficit of \$20,000,000 is not, however, as simple as it may seem at first glance. The resources of the country are primarily agricultural. Disturbed conditions have seriously curtailed agricultural activity and consequently restricted production. Even where conditions permit resumption of work, the landowners are unable to operate their properties to anything like normal averages because they lack working capital. In many cases in rural districts greedy military chiefs have seized portions of crops and have otherwise discouraged landowners from attempting resumption of agricultural work. The problem is being worked out slowly, but, where a country has gone through several years of chaos it must inevitably take some

time to get back to normal conditions. Taxes on mines and oil production are as high as conditions warrant, and taxes on manufactured products cannot be increased without risk of killing industry. No further increase in taxes can be made on urban property without placing too much hardship on the tenants. Customs duties, if further increased, would only result in the restriction of trade. In other words, for increased revenue Mexico must look to her normal source of wealth, agriculture, and increased revenue from this source will come more or less slowly. It may be worth while, incidentally, to call attention to the general scheme of taxation in Mexico. The whole system is based on production. This scheme has been largely responsible for the existence of estates of enormous size. In the future some equitable form of land tax will have to be provided, but any attempt along this line at the moment would only amount to confiscation of properties.

THE USE OF FORCE UNWISE

For some years representatives of leading financial interests have said that Mexico must be made to pay her debts. Men of supposedly able brains have said that sooner or later the United States would force her to settle. Holders of British securities of concerns doing business in Mexico have said, rather glibly, that as soon as the war was over Great Britain would take the matter in hand, and that their government, either directly or through pressure on Washington, would dictate terms. This sort of talk implies either a refusal on the part of Mexico to meet her obligations, or a desire, through foreign intervention, to dominate the situation. Mexico has made no suggestion of repudiation, but simply has been unable, due to internal troubles, to meet her obligations. Any foreign intervention would be costly for all concerned—in dollars and cents would represent a tremendous expense.

Since we have had a practical demonstration, on a vast scale, of the cost of war, there has been some talk of bringing economic pressure on Mexico. This seems equally foolish, assuming, of course, that there are any hopeful signs in Mexico. Economic pressure can only mean one thing—wringing something out of the country at the expense of greater internal trouble. Mexico has

emerged from a state of chaos, and politically, socially and economically she is making progress. Given some financial help—not only in money but in the support of those interested materially—she will work her way out.

I have no desire to pose as an apologist for Mexico, and fully realize what foreigners and foreign capital have experienced during the past few years. I also realize that there are many serious problems confronting the government—political, financial, social and economic—and that these problems will require much time and patience in their period of solution. It seems to me, however, that a careful study of the situation would convince any reasonable person that the problems are receiving due consideration, and that every day brings Mexico nearer to the point of being able to take care of herself without outside aid or interference.

THE OUTLOOK IS ENCOURAGING

Elsewhere¹ I have dealt at length with Mexico's relations with foreign capital. The general conclusion reached in a study of the situation was that it would be quite useless to make on Mexico demands which she could not meet, and that all having interests in Mexico should unite to aid in a program which will enable her to get on her feet. Discussion of past troubles is idle. What is needed is material and moral aid in a constructive program. In this connection, it is worth while to call attention to the showing of the National Railways Company. That company, during the years 1909 to 1913, earned (gross) about \$2,500,000 per month. Due to revolutionary troubles, paper currency and incidental causes, the earnings of the system dropped, by January, 1915, to \$93,000. In January, 1916, gross earnings were \$501,000, while a year later the figures were \$1,336,000, and today monthly earnings, even excluding traffic handled for the government—troop trains and so forth—exceed \$2,500,000. These figures clearly indicate that Mexico is rapidly "coming back."

In closing, I wish to make reference to the suggestion that Mexico could arrange a foreign loan by pledging certain specific taxes. This idea is a fallacy, as it assumes that such income can be spared. Moreover, financing on this sort of a basis is almost

¹In "*Mexico Today and Tomorrow*" (The Macmillan Company, 1919).

certain to interfere with permanent financial stability. It may be compared to a manufacturing institution which borrows money from a dozen banks, giving its real estate as security to the first, its machinery to the second, its unfinished product to a third, its bills receivable to a fourth, and so on. If anything happens to upset the equilibrium, the claims of the different creditors tear the property to pieces, whereas, with one creditor, there would always be a chance of preserving the property intact. Professor Henry C. Adams² says:

A sound financial policy will not impair the patrimony of the state. . . . It is a fundamental principle of constitutional law that each legislature shall hand down to its successor all the rights and powers and jurisdictions which it received from its predecessor; so in matters of public finance it is incumbent that each succeeding administration shall find as broad a field from which to supply its needs and as fruitful a source of supply as the administration which preceded it.

Mexico's creditors should get together, arrange to give her sufficient money to care for urgent needs, give her time to get back to a normal basis, arranging for resumption of interest payments on a graduated basis, and lay out a permanent financial structure which will put the future credit of the government on a sound basis.

² *Finance*, p. 4.